Taxes

Administration's Tax Agenda Increases the Deficit — The Administration's stated tax agenda reduces revenues by $1.7 trillion over ten years (2007-2016). When the cost of a ten-year repair of the AMT is factored in – along with the cost of servicing the additional debt caused by this tax agenda – the Administration's tax policies worsen the deficit by $3.0 trillion.

Tax Cuts Do Not "Pay for Themselves;" Revenues Collected Since Enactment of the Tax Cuts Are Far Below Projected Levels — Some conservative economists claimed that the 2001 tax cuts would generate such remarkable growth in income that revenue collected would be higher after the tax cuts due to the expanded tax base, implying that the tax cuts would "pay for themselves." The deterioration in tax receipts since 2001 shows this not to be the case. In the Administration's 2002 budget, it was stated that the President's budget would "achieve historic levels of debt reduction" and the Administration projected that tax revenues would amount to $11.4 trillion between 2001 and 2005. After five years of budget deficits, the tax cuts have failed to produce the expected results, with the Treasury instead raising $9.7 trillion since 2001 – $1.7 trillion below the projected level.

The Joint Committee on Taxation's estimates of the cost of the President's three major tax cuts sum to $1.5 trillion between 2001 and 2014, without incorporating the additional costs of debt-servicing. Even the most ardent supporters of the tax cuts admit that the revenue growth claimed to be generated by the cuts would not be sufficient to compensate for the lost revenue. Josh Bolten, Director of the Office of Management and Budget, recently stated in a House Budget Committee hearing:

> Economists are in disagreement about the size of what the dynamic effect is, and I'm hopeful that they will come to some agreement soon. But you're right. I'm not arguing that a dollar of tax cut produces a dollar of tax revenue.

While economists still disagree over whether tax cuts adopted in a time of growing deficits are harmful or helpful to long-run economic growth, these comments reinforce the well-established notion that tax cuts do not "pay for themselves."

***Reductions in Revenue Cannot Be Blamed on Recent Events* —** Conservative economists point to the September 11th attacks as the justification behind the dramatic reversal in the budget outlook. But the economic impact of September 11th was temporary, a fact that has been supported by both liberal and conservative economists. At a House Budget Committee hearing in 2004, Alan Greenspan stated:

> Immediately after 9/11 we had expected a very significant contraction in economic activity, which was likely to be prolonged. Within a matter of weeks, or a few months at the longest, it became quite evident that the economy had achieved a degree of resiliency which we had not expected it had, and it stabilized reasonably quickly and started to grow again at a fairly modest but eventually accelerating pace.

The Budget Reduces Benefits for Certain Low and Middle-Income Taxpayers — The budget changes the eligibility guidelines for the Earned Income Tax Credit (EITC) and the Child Tax Credit so that certain taxpayers no longer qualify for these benefits. By making the standards for claiming these credits more stringent, the budget decreases the aggregate benefit of these two tax credits by $2.1 billion over five years and $5.0 billion over ten years. Since these benefits are most beneficial to low and middle-income taxpayers, particularly those who are working and have families, the inclusion of this cut makes the President's tax agenda more biased against working-class families.

The President's Tax Cuts Preserve the Gap Between Earned and Unearned Income — The current tax code favors unearned income, such as capital gains and inheritance income, relative to earned income, such as wages and salary. If the President's tax cuts are extended, including the repeal of the estate tax and extension of the lower tax rates on capital gains and dividend income, this bias against employment income would be preserved. Under the President's budget, income received as inheritance will not be taxed at all, income received through the sale of a capital asset will be subject to a maximum rate of 15 percent, while income earned through employment will be taxed at a the payroll rate of 7.65 percent in addition to income tax rates up to 35 percent. The inclusion of the Lifetime Savings Accounts and Retirement Savings Accounts further rewards capital income relative to labor income. A tax code with such unbalanced incentives discourages income from employment relative to other income streams, a contradiction for an Administration that claims to value the virtues of employment.

Tax Cuts Increase Dependence on Foreign Investors and Threaten America's Economic Security — The rapid increase in national debt under the Bush Administration has led to an upsurge in debt held by foreign investors, as the U.S. Treasury has increasingly turned to private foreign investors and central banks to finance annual deficits. Foreign-held debt has doubled under the Bush Administration; by November 2005, almost half the publicly held debt, approximately $2.2 trillion or 46.2 percent, was in the hands of foreign investors. This is a fundamentally different situation than in the 1980's, when debt as a percentage of GDP was also high, but mostly held by American investors. Many economists see this as a troubling situation, since it makes the U.S. economy vulnerable to investment actions and political decisions by foreign holders of U.S. Treasury securities. Also, the cost of servicing this debt means that billions of dollars will annually flow outside the U.S., causing reductions in future standards of living as a higher proportion of future income is devoted to interest payments.

Tax Cuts Provide the Most Benefit to the Most Fortunate — The bulk of the President's tax cuts are focused on those taxpayers at the top of the income distribution who are least in need of tax relief. The Brookings-Urban Tax Policy Center estimates that the extension of the President's tax cuts will result in almost half of the total tax cut, 45 percent, going to the four percent of filers with incomes over $200,000. Tax filers with incomes in excess of $1 million will receive an average tax cut in 2010 of approximately $155,000, about one hundred times the tax cut for the average taxpayer. In addition to raising concerns about fairness, a tax cut disproportionately targeted to the most fortunate distributes the benefits of the tax break in a way that does not adequately stimulate consumer demand for goods and services.

Revenues as a Percentage of GDP Are Near Lowest Level in Decades — Under the Administration's policies, revenues as a percentage of Gross Domestic Product (GDP) are estimated to be 17.5 percent for 2006. During the Bush Administration, revenues as a percent of GDP have averaged 17.6 percent – about a full percentage point below the average over the two decades prior to the start of the Bush Administration. Moreover, this situation would be worse if not for the contribution of social insurance taxes to the revenue stream. Without this off-budget revenue, the Administration's record on sufficient tax revenue is even more worrisome. For example, individual income taxes, which comprise the largest share of revenues in the budget, are at their lowest levels since the 1960's.

New Tax Cuts for High-income Households Use Gimmicks to Hide Budget Costs — The budget includes a provision, as it did last year, to allow households to place $5,000 per family member each year in tax-sheltered "Lifetime Savings Accounts" (LSAs). Earnings on the accounts and withdrawals from them would be tax-free. Households could also annually place another $5,000 each for the taxpayer and the spouse into a tax-sheltered "Retirement Savings Account" (RSA). These RSAs would replace IRAs, but the income limits on who can use IRAs would be eliminated. Few of the benefits from these new savings accounts would go to families with incomes under $100,000, because most such families can already make comparable investments in IRAs, and few such families have such large amounts to invest. Because the proposals would encourage high-income households to cash out existing accounts (often paying capital gains taxes) in order to move assets into the new tax-sheltered accounts, the proposals would generate revenues in the short run. After the first five years, however, the proposals would reduce revenues substantially. The Brookings-Urban Tax Policy Center estimates that the proposals, when fully in place, could cost as much as $35 billion per year.

The President's Tax Cuts Place Undue Burden on Social Security Revenues — The growth in the unified federal budget deficit would have been even greater if not for the excess Social Security payroll tax revenues generated over the past few years. By cutting taxes on unearned income, such as capital gains, inheritance, and dividend income, the President's tax agenda increases the reliance on payroll taxes and makes the tax code more regressive. Social insurance taxes now comprise 37 percent of federal revenues, up from 32 percent in 2000; the budget maintains this high proportion, collecting 36 percent of the revenue from social insurance taxes in 2011. This shift in revenue source not only places an undue burden on those taxpayers whose primary income is from wages and salary, but it also weakens the nation's Social Security system.

The Omission of AMT Reform Greatly Understates the Cost of Tax Cuts — The President's budget includes an extension of tax cuts for capital gains and dividend income, but excludes any provision for repairing the AMT. If the AMT is not adjusted, an estimated 31 million taxpayers will be subject to the tax in 2010, making its reform nearly inevitable. Since the AMT "adds back" a significant portion of the extension of capital gains and dividend income tax cuts, it is important to consider the cost of the two cuts together when estimating the realistic cost of reform. Combining the cost of adjusting the AMT with the cost of the President's proposed tax cuts increases the deficit by $2.5 trillion over ten years, before accounting for the extra cost of interest payments or assuming an extension of the law allowing the deduction of non-refundable personal credits under the AMT. The cost of fixing the AMT is $844 billion if the President's tax cuts are made permanent.